

Message Text

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ACTION ARA-14

INFO OCT-01 ISO-00 EB-08 MMO-01 TRSE-00 COME-00 LAB-04
AGRE-00 INT-05 DODE-00 CIAE-00 NSAE-00 XMB-02
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R 222140Z AUG 77
FM AMEMBASSY SAN SALVADOR
TO SECSTATE WASHDC 5259
INFO AMEMBASSY GUATEMALA
AMEMBASSY MANAGUA
AMEMBASSY SAN JOSE
AMEMBASSY TEGUCIGALPA

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EO 11652: NA
TAGS: ECON, ES
SUBJ: EL SALVADOR: ECONOMIC ALERT REPORT

REF: STATE 180067

1. AT PRESENT, THREE DEVELOPMENTS APPEAR LIKELY TO INFLUENCE THE SALVADORAN ECONOMY'S PERFORMANCE OVER THE NEXT TWO OR THREE YEARS: THE PRICE OF COFFEE, INFLATION, AND THE SLACK IN PRIVATE SECTOR INVESTMENT. FOR THE PAST TWO YEARS, EL SALVADOR HAS EXPERIENCED WINDFALL GAINS FROM THE RECORD PRICES FOR CO FEE ATTAINED AFTER THE JULY, 1975 BRAZILIAN FROST. SINCE MID-APRIL OF THIS YEAR HOWEVER, THE WORLD PRICE OF COFFEE HAS TAKEN A PRECIPITOUS DROP. DECLINING CONSUMPTION AND INCREASING PRODUCTION SUGGEST THAT THE PRICE WILL DROP FURTHER, REACHING A NEAR NORMAL LEVEL BY 1979. SINCE THE SALVADORAN ECONOMY IS HEAVILY DEPENDENT ON COFFEE, THE EXPECTED DECLINE IN THAT COMMODITY'S PRICE WILL HAVE SERIOUS CONSEQUENCES.

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2. THE COFFEE BONANZA HAS BEEN ACCOMPANIED BY, AND HAS PARTLY FED, A PERSISTENT INFLATION. THIS INFLATION IS LINKED TO THE GENERAL RISE IN WORLD PRICES WHICH BEGAN IN THE EARLY YEARS OF THIS DECADE.

3. THE PERIOD SINCE JUNE, 1976 HAS BEEN MARKED BY A HIGH DEGREE OF POLITICAL TURMOIL IN EL SALVADOR. CONTINUING DOUBTS ABOUT THE

COUNTRY'S FUTURE HAVE DEPRESSED PRIVATE SECTOR CONFIDENCE AND HENCE, PRIVATE SECTOR CAPITAL FORMATION. THIS ACCENTUATES A TENDENCY, NOTED OVER THE PAST TEN YEARS, FOR PRIVATE SECTOR INVESTMENT TO LAG.

4. OUTLOOK. THE TRENDS DESCRIBED ABOVE SUGGEST A RETURN WITHIN THE NEXT TWO OR THREE YEARS TO A SITUATION SIMILAR TO THAT WHICH CONFRONTED THE COUNTRY IN 1974 AND 1975--BALANCE OF PAYMENTS DEFICITS, INFLATION AND SLUGGISH GROWTH. IN THE EMBASSY'S VIEW, THIS DETERIORATION WILL NOT BECOME FULLY APPARENT OVER THE NEXT TWELVE MONTHS. EL SALVADOR WILL PROBABLY FINISH 1977 WITH A SIZEABLE SURPLUS ON BALANCE OF PAYMENTS AND A HEALTHY RATE OF REAL GROWTH. (ON THE ORDER OF 6 OR 7 PERCENT). THIS WILL BE DUE IN LARGE PART OF THE COFFEE BOOM. A CONTINUED DECLINE IN THE WORLD PRICE OF COFFEE HOWEVER, WILL ALMOST SURELY RESULT IN A BALANCE OF PAYMENTS DEFICIT IN 1978. SIMULTANEOUSLY WITH THIS DETERIORATION ON EXTERNAL ACCOUNT, THE CONTINUING INFLATION AND SLACK IN PRIVATE SECTOR CAPITAL FORMATION SHOULD BEGIN TO SLOW ECONOMIC GROWTH. THIS COMBINATION OF SLUGGISH GROWTH WITH INFLATION AND BALANCE OF PAYMENTS DEFICITS WILL BE HARD FOR THE GOES TO DEAL WITH.

5. FUNDAMENTALLY, THE COFFEE BONANZA HAS POSTPONED FOR TWO OR THREE YEARS THE NECESSITY FOR EL SALVADOR TO ADJUST TO THE CHANGES IN THE WORLD ECONOMY WHICH OCCURRED IN THE EARLY SEVENTIES. SUCH AN ADJUSTMENT CAN ONLY COME THROUGH A REDUCTION IN LIMITED OFFICIAL USE

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CURRENT CONSUMPTION IF THE RHYTHM OF INVESTMENT IN DEVELOPMENT PROJECTS IS NOT TO BE SLOWED.

6. CRITICAL POINTS. THE EVOLUTION OF THE WORLD PRICE OF COFFEE WILL BE THE CRUCIAL FACTOR IN DETERMINING THE SEVERITY OF THE GOES' PROBLEMS. WE EXPECT NO MAJOR CHANGES IN GOES ECONOMIC POLICY OVER THE COMING YEAR. IF, AS WE EXPECT, PROBLEMS ARE APPARENT BY THE END OF 1978, REVIEWED CREDIT RESTRAINT, IMPORT RESTRICTIONS AND TIGHTENING OF EXCHANGE CONTROLS CAN BE EXPECTED. IF THE SITUATION WORSENS THROUGH 1979 AND INTO 1980, MORE SERIOUS MEASURES, SUCH AS DEVALUATION, MAY BE CONSIDERED. SHORT AND MEDIUM TERM INDEBTEDNESS MAY BEGIN TO BE A WORRY.

7. USE POLICY IMPLICATIONS. IT IS DOUBTFUL THAT THE SHORT TO MEDIUM TERM PROBLEMS DESCRIBED ABOVE WILL REQUIRE A SPECIFIC US POLICY RESPONSE. AS IS WELL KNOWN HOWEVER, THE SALVADORAN ECONOMY HAS SERIOUS STRUCTURAL PROBLEMS--OVERPOPULATION, UNEMPLOYMENT, MALDISTRIBUTION, ILLITERACY, AND OTHERS--WHICH LARGELY CONDITION US POLICY TOWARD EL SALVADOR. ACCORDINGLY, AS SHORT TERM ECONOMIC PROBLEMS BEGIN TO REAPPEAR, A CONTINUED FLOW OF US AND MULTILATERAL ECONOMIC ASSISTANCE WILL ASSUME INCREASING IMPORTANCE. AT THE PRESENT TIME, THE USG IS CON-

SIDERING WHETHER THE HUMAN RIGHTS SITUATION IN EL SALVADOR
JUSTIFIES US SUPPORT FOR IFI LOANS AND A REVIEW OF US BILATERAL
ASSISTANCE. SAN SALVADOR 3767 IS THE MOST RECENT EMBASSY
CONSIDERATION OF THE POLICY QUESTIONS RAISED BY THE HUMAN RIGHTS
SITUATION IN EL SALVADOR. IN OUR VIEW, ITS CONCLUSION THAT
WITHDRAWAL OF ECONOMIC ASSISTANCE TO EL SALVADOR WOULD BE AN
INAPPROPRIATE RESPONSE TO HUMAN RIGHTS VIOLATIONS IN EL SALVADOR
IS REINFORCED BY THE SHORT-TERM ECONOMIC PROBLEM WE BELIEVE
LIE JUST OVER THE HORIZON.
LUBENSKY

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